SHEARMAN & STERLING LLP

FINANCIAL INSTITUTIONS ADVISORY & FINANCIAL REGULATORY GROUP
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# Financial Regulatory Developments Focus

**In this week's newsletter, we provide a snapshot of the principal US, European and global financial regulatory developments of interest to banks, investment firms, broker-dealers, market infrastructure providers, asset managers and corporates.**

## In this Issue (please click on any title to go directly to the corresponding discussion):

## Bank Prudential Regulation & Regulatory Capital

### US Office of the Comptroller of the Currency Issues Risk Management Guidance

On August 4, 2015, the Office of the Comptroller of the Currency issued guidance outlining safety and reliability measures that national banks and federal savings associations offering tax refund-related products should follow. The term "tax refund-related products" includes credit products, deposit products, and settlement services to transmit tax-related funds. According to the OCC, tax refund-related products present particular safety and compliance risk because of: (i) their unique repayment and cost structures; and (ii) banks' reliance on third-party tax return preparers who interact with customers. Among other things, some of the suggested measures outlined by the OCC include ensuring that the board of directors maintains sound risk management policies, implementing effective internal controls and review for advertising and solicitation, providing appropriate disclosures to consumers and otherwise complying with applicable consumer protection laws and regulations, implementing adequate procedures to ensure that tax refund-related products provided by third parties comply with applicable guidance, ensuring that Bank Secrecy Act systems include tax refund-related products and maintaining adequate capital and liquidity levels.

The bulletin is available at: http://www.occ.gov/news-issuances/bulletins/2015/bulletin-2015-36.html.

### European Commission Assesses Level of Prudential Rules under Capital Requirements Legislation

On August 5, 2015, the European Commission published a report on its assessment of the appropriateness of the rules governing the levels of application of the prudential requirements under the Capital Requirements Directive and the Capital Requirements Regulation, together CRD IV. In the EU, subject to certain exceptions, the supervision of a banking group which includes several banks or investment firms is undertaken at the level of the entire banking group (so called consolidated supervision) as well as at the individual level. The outcome of the assessment is that the Commission does not think that it is appropriate to propose amendments to the rules at this time as consideration needs to be given to the impact of the Single Supervisory Mechanism, implementation of the liquidity coverage requirement and the application of the Bank Recovery and Resolution Directive.

The report is available at: http://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-388-EN-F1-1.PDF.

### European Banking Authority Consultation on Exclusion of Transactions with Non-EU Non-Financial Counterparties from Credit Valuation Adjustment Risk

On August 5, 2015, the European Banking Authority published a consultation paper including draft Regulatory Technical Standards on the procedures for excluding a firm's transactions with Non-Financial Counterparties established in non-EU countries from the own funds requirements for Credit Valuation Adjustment risk under the CRR. A firm's transaction with a NFC is excluded from the own funds requirements for CVA risk under the CRR, whether or not the NFC is established in the EU. This is the case as long as transactions do not exceed the clearing threshold specified in the European Market Infrastructure Regulation. As NFCs established in non-EU countries are not subject directly to EU regulation, the draft RTS clarify that firms are responsible for: (i) taking the necessary steps to identify all NFCs under this exemption and calculating accordingly their own funds requirements for CVA risk; (ii) ensuring that exempt counterparties established outside the EU would qualify as NFCs if they were established in the EU; and (iii) ensuring that counterparties calculate the clearing threshold according to the relevant provisions in EMIR and do not exceed those thresholds. The draft RTS align the treatment of NFCs established in a non-EU country with the treatment of NFCs established in the EU. Comments are due by November 5, 2015.

The consultation paper is available at: http://www.eba.europa.eu/documents/10180/1155417/EBA-CP-2015-14+%28CP+on+RTS+on+CVA+exemption%29.pdf.

### European Commission Intends to Amend Draft Technical Standards on Additional Monitoring Metrics for Liquidity Reporting

On August 6, 2015, the European Commission issued a press release dated July 24, 2015 announcing its intention to amend the draft Implementing Technical Standards on additional monitoring metrics for liquidity reporting under the CRR. The draft ITS set the amount and quality of capital that a bank must hold to absorb losses and also sets a general liquidity requirement for banks. The main amendment to the draft ITS concerns the removal of the "maturity ladder" template and its related instructions. This template lists the maturity of liquid assets as well as the expected timing of cash inflows and outflows for firms according to 22 timelines ranging from overnight to over 10 years. The amendment will ensure that the draft ITS aligns with the definition of

"liquid assets" in the Commission's Delegated Regulation on the liquidity coverage requirement for banks which includes the liquidity coverage ratio and the liquidity buffer. The Commission also intends to amend the proposed date of application of the draft ITS from July 1, 2015 to January 1, 2016.

The Commission's press release is available at:
http://ec.europa.eu/finance/bank/docs/regcapital/acts/its/20150724_announcement_en.pdf.

## Compensation

### US Securities and Exchange Commission Adopts Rule for Pay Ratio Disclosure under Dodd-Frank

On August 5, 2015, the US Securities and Exchange Commission adopted final rules implementing the pay ratio disclosure requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The final rules would, among other things, require a public company to disclose: (i) the annual total compensation of its CEO; (ii) the median annual total compensation of its other employees; and (iii) the ratio of those two amounts, commonly referred to as the "pay ratio." That information must be disclosed in registration statements, proxy and information statements and annual reports that require executive compensation disclosure. According to the SEC press release adopting the final rule, the purpose of the requirements is to increase the transparency that shareholders of companies have into details of a company's CEO compensation.

To address concerns regarding the cost of compliance, the final rule allows flexibility in calculating the pay ratio. For example, a company may select its own methodology for identifying its median employee and that employee's compensation, including through statistical sampling of its employees or other methods. In addition, the final rule permits companies to exclude certain non-US employees from the calculation where the privacy laws or regulations of the applicable countries would prohibit such disclosures in order to comply with the rule. Companies will be required to make their first pay ratio disclosures pay ratios in relation to compensation paid in the first full fiscal year beginning on or after January 1, 2017.

The SEC press release is available at: http://www.sec.gov/news/pressrelease/2015-160.html and the text of the final rule is available at: http://www.sec.gov/rules/final/2015/33-9877.pdf.

The Shearman & Sterling client publication describing the final rule is available at:
http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/08/The-SECs-Final-Pay-Ratio-Rules-What-You-Need-to-Know-ECEB-081015.pdf.

## Derivatives

### US Securities and Exchange Commission Adopts Final and Proposed Rules for Security-Based Swap Dealers and Major Security-Based Swap Participants

On August 5, 2015, the SEC adopted final rules under Dodd-Frank providing for the registration of security-based swap dealers and major security-based swap participants. Under the final rules, security-based swap dealers and major security-based swap participants, collectively referred to as SBS Entities, will be granted conditional registration status after filing an application with the SEC and providing certain senior officer certifications, pending the SEC's review of the application. The SEC will then review the application to either grant ongoing registration or institute proceedings to deny registration to the SBS Entity. The registration process requires the submission by an SBS Entity of information about its business activities, structure and background as well as information about their control affiliates. Although the final rule will become effective 60 days after publication in the Federal Register, the compliance date for the final rules will depend on the timing of implementation of certain other security-based-swap-related final rules.

Additionally, on August 5, 2015, the SEC issued proposed rules, which would provide a process for a registered SBS Entity to apply to the SEC for an order permitting the SBS Entity to continue effecting security-based swaps through an associated person who is subject to a statutory disqualification. The SEC may issue an order granting such relief if it would be consistent with the public interest to permit such a person to be engaged in effecting security-based swaps notwithstanding the statutory disqualification. Comments on the proposed rule are due 60 days after publication in the Federal Register.

The SEC press release is available at: http://www.sec.gov/news/pressrelease/sec-adopts-registration-rules-for-security-based-swap-dealers.html, the text of the final rule for registration of SBS Entities is available at: http://www.sec.gov/rules/final/2015/34-75611.pdf and the text of the proposed rule is available at: http://www.sec.gov/rules/proposed/2015/34-75612.pdf.

### US Office of the Comptroller of the Currency Issues Guidance Regarding Quantitative Limits on Physical Commodity Transactions

On August 4, 2015, the OCC issued a bulletin clarifying its expectations regarding the extent to which national banks and federal branches or agencies of foreign banks may make or take delivery of a physical commodity to hedge commodity derivatives risks. Among other things, the bulletin includes guidance on the calculation required to determine whether physical hedging activities are a nominal portion of risk management activities. Pursuant to the OCC bulletin, physical hedging positions are considered "nominal" if the bank's commodity position is no more than 5 percent of the notional value of the bank's derivatives that: (i) are in that particular commodity; and (ii) allow for physical settlement within 30 days. The guidance also reiterates the OCC's expectation that a bank, prior to engaging in physical commodity hedging activities, should submit to the OCC a detailed plan for such activities and receive from the OCC a prior written supervisory nonobjection.

The OCC bulletin is available at: http://www.occ.gov/news-issuances/bulletins/2015/bulletin-2015-35.html.

### Mandatory Clearing of OTC Interest Rate Swaps a Step Closer in the EU

On August 6, 2015, the European Commission announced that it had adopted legislation which, once it comes into force, will make it mandatory to clear certain OTC interest rate swaps through CCPs. The obligation will apply to fixed-to-float IRS, known as plain vanilla IRS derivatives, float-to-float swaps, known as basis swaps, forward rate agreements and overnight index swaps which are denominated in euro, pounds sterling, Japanese yen or US dollars. The legislation is now subject to scrutiny by the European Parliament and the Council of the European Union. Mandatory clearing of these derivatives contracts represents the first mandatory clearing obligation under the European Market Infrastructure Regulation. It is expected that the European Securities and Markets Authority will in the near future propose mandatory clearing obligations for other types of OTC derivatives.

The announcement is available at: http://europa.eu/rapid/press-release_IP-15-5459_en.htm?locale=en.

### International Organization of Securities Commissions Report on Post-Trade Transparency in Credit Default Swaps Market

On August 7, 2015, the International Organization of Securities Commissions published its final report on post-trade transparency in the Credit Default Swaps market. The report discusses the impact of mandatory post-trade transparency in the CDS market generally, including the disclosure of price and volume of individual transactions. The report states that member jurisdictions should take further steps, including adopting legislation or implementing other legal powers where necessary, to enhance post-trade transparency in the CDS market.

The report is available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD499.pdf.

## Enforcement

### UK Regulators Publicly Censure the Co-operative Bank for Risk Management Failings

On August 10, 2015, the Prudential Regulation Authority and Financial Conduct Authority issued final notices publicly censuring the Co-operative Bank Plc for serious risk management and transparency failings, breach of the FCA listing rules and for failing to be open and co-operative with both of the regulators. The PRA and FCA carried out a joint investigation and found serious breaches and failings in the bank's systems between July 2009 and December 2013. The PRA focused its investigation on the bank's risk management framework, capital management and corporate lending policies, whist the FCA focused on the bank's publication of false and misleading information on the bank's capital, which amounted to breaches of the listing rules. The regulators found, amongst other things, that the bank had: (i) inadequately assessed the level of risk it assumed, leading to a failure to manage that risk; (ii) mismanaged the information that it produced, leading to the bank's Board not being familiar with key issues affecting the bank's business; and (iii) prioritized its short-term financial position without taking reasonable and prudent actions for the longer-term. Both the FCA and PRA also noted the lack of notification to them of changes in senior management at the bank. These failings would usually trigger considerable fines however the regulators are not imposing any

financial penalty, deeming it more appropriate to issue a public censure, in the interest of maintaining the safety and soundness of the firm. The regulators also took into account the turnaround plan that the bank has put in place to remedy the failings and to meet the individual capital guidance provided by regulators. The PRA would have otherwise imposed a significant fine of around £120 million on the bank.

The final notices are available at:
http://www.bankofengland.co.uk/pra/Documents/supervision/enforcementnotices/en110815.pdf; and
http://www.fca.org.uk/static/documents/final-notices/the-co-operative-bank-plc-2015.pdf.

## Financial Market Infrastructure

### US Comptroller of the Currency Discusses Responsible Innovation and Risk Management

On August 7, 2015, the Comptroller of the Currency Thomas J. Curry gave a speech at a conference sponsored by the Federal Home Loan Bank of Chicago, entitled "Leading Toward the Future; Ideas and Insight for a New Era." In that speech, Mr. Curry discussed the ways in which innovation can benefit the financial system, the crucial role banks play in spurring such innovation, and efforts the OCC is undertaking to better comprehend the benefits and risks of innovative products and services. Mr. Curry noted that the OCC must develop a robust process in order to evaluate new approaches and encourage responsible innovation, while ensuring appropriate risk management and compliance with laws and regulations.

The speech is available at: http://www.occ.gov/news-issuances/speeches/2015/pub-speech-2015-111.pdf

### European Securities and Markets Authority Provides Technical Advice under Central Securities Depositories Regulation

On August 5, 2015, ESMA published its technical advice to the European Commission under the Regulation on improving securities settlement in the European Union and on central securities depositories, known as CSDR. The technical advice will be considered by the Commission in its preparation of delegated acts which it is required to pass under the CSDR. The technical advice is on penalties for settlement fails and on the substantial importance of a Central Securities Depository. Under CSDR, there is an obligation to settle instructions on the intended settlement date and a daily cash penalty applies for any failed settlement. ESMA's technical advice is on the parameters for calculating the basic amount of the cash penalty, including the circumstances which may justify an increase or a reduction in the basic penalty amount. An EU passport is provided for under the CSDR which allows an EU-registered CSD to provide its services in any EU member state. Cooperation arrangements are required to be established between the home and host member states for the supervision of the CSD, in particular where the activities of the CSD are of "substantial importance for the functioning of the securities markets and the protection of investors" in the host member state. The Commission's delegated act is required to set out which operations of a CSD could be considered of substantial importance.

The technical advice is available at: http://www.esma.europa.eu/news/ESMA-advises-Commission-implementation-CSD-Regulation?t=326&o=home.

## Recovery & Resolution

### European Banking Authority Publishes Guidelines under Bank Recovery and Resolution Directive

On August 6 and 7, 2015, the EBA published final translations of certain of its Guidelines which are required under the Bank Recovery and Resolution Directive. The Guidelines are on: (i) the interpretation of the different circumstances in which a firm will be considered as failing or likely to fail; (ii) the minimum list of "critical" services or facilities that are necessary to enable a recipient to operate a business transferred to it; (iii) the asset separation tool, which provides guidance on the assets that may be transferred to an asset management vehicle (known as a "bad bank"); and (iv) the sale of business tool, which specifies how national regulators can deviate from standard marketing requirements for the sale of a business under resolution, if that failure presents a material risk to financial stability. National regulators must notify the EBA within two months of the publication of the translated guidelines whether they comply or intend to comply with those guidelines.

The Guidelines are available at: http://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/guidelines-on-failing-or-likely-to-fail; http://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/guidelines-on-necessary-services;

http://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/guidelines-on-the-asset-separation-tool/-/regulatory-activity/press-release; and http://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/guidelines-on-the-sale-of-business-tool.

### UK Waiver for Firms on Depositor Protection Notifications

On August 5, 2015, the PRA published new waivers for firms on the notifications required for depositor protection. The recent changes require firms to notify all depositors of the limit change from £85,000 to £75,000 by September 1, 2015 and provide the Information Sheet to depositors between January 1 and July 1, 2016. The PRA's preference is that firms send out the notification of changes to all depositors by September 1, 2015 and do not send out the Information Sheet or exclusions notification before January 1, 2016. However, to relieve some of the burden on firms, the PRA will allow firms to send the deposit limit change notification by September 1, 2015 to any depositor who is no longer covered by the depositor protection scheme and any depositor who holds aggregate eligible deposits of over £50,000 and either: (i) make the required systems or other changes to ensure that no Information Sheets or exclusions notifications are sent to depositors prior to January 1, 2016; or (ii) amend the Information Sheet to the new limit of £75,000 and send it with the exclusions notification on account opening and as an annual mailing between now and July 1, 2016.

The modification by consent is available at:
http://www.bankofengland.co.uk/pra/Documents/authorisations/waiverscrr/moddeppro.pdf.

## People

### Stephen W. Warren Named the OCC's Chief Information Officer

On August 6, 2015, Stephen W. Warren was named Chief Information Officer at the OCC. He will join the OCC on September 6, 2015.

### Linda Cunningham Named the OCC's First Chief Risk Officer

On August 5, 2015, Linda Cunningham was named the first Chief Risk Officer at the OCC.

## Upcoming Events

August 20, 2015: EBA Public Hearing on guidelines for the prudential assessment of acquisitions of qualifying holdings in the financial sector (registration closed).

September 1, 2015: EBA Public Hearing on conditions for national regulators to raise risk weights and loss given default floors for mortgage exposures (registration closed).

September 4, 2015: EBA Public Hearing on Call for Evidence on bank lending to Small and Medium-sized Enterprises and the capital reduction factor for loans to SMEs known as the Supporting Factor (registration deadline: August 14, 2015).

September 8, 2015: Agency for the Cooperation of Energy Regulators public workshop on the implementation of the Regulation on Energy Market Integrity and Transparency and disclosure of inside information (registration deadline: September 4, 2015).

September 23, 2015: FCA and Organization for Economic Co-operation and Development conference to discuss practical regulation, research and policy for consumer financial protection (registration deadline: August 14, 2015).

October 7, 2015: EBA Public Hearing on proposed guidelines on cooperation agreements between deposit guarantee schemes (registration deadline: September 16, 2015).

October 12, 2015: EBA Public Hearing on CVA exemption of NFCs established in a third country (registration deadline: September 21, 2015).

This newsletter is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired. If you wish to receive more information on the topics covered in this publication, you may contact your usual Shearman & Sterling representative or any of the following:

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